CANADA

NEWSLETTER

PRIMER FOR SHARE-BASED PAYMENTS

FEBRUARY 2022

KNAV
PARTNERS BEYOND BOUNDARIES


Rajesh C Khairajani
Partner
Valuations

Kinjal Shah
Manager
Valuations

Share-based payments are gaining traction in entities across all life cycles, from start-up to growth to maturity. This newsletter delves into the accounting and tax compliances for this popular form of employee compensation. The focus of the newsletter is on the valuation requirements of Employee Stock Options Plan ("ESOP").

FINANCIAL REPORTING ASPECT: International financial reporting standard 2 - Share based payments ("IFRS 2")

Measurement under IFRS 2

The measurement requirements for ESOP awards is governed by IFRS 2 which specifies the standard of value as fair value. However, it is pertinent to note that the "fair value" referred to in IFRS 2 is not the same as the "fair value" as defined by IFRS 13: Fair value measurement. In fact, IFRS 13 excludes share based payments from its scope. The key reason for this exclusion is that while IFRS 13 requires considering market participant assumptions, the inputs considered in determining the fair value under IFRS 2 must incorporate company specific factors, specifically the vesting conditions.

This section discusses those provisions of IFRS 2 which necessitate the fair valuation of the ESOP award.

At the time of grant

In case of share settled awards, generally classified as equity, the **grant date** fair value of the Employee stock option is considered as an indirect reference to determine the fair value of the employee services towards which the Employee stock options are awarded. Cash settled awards are classified as liabilities per IFRS 2. Similar to equity awards, the liability awards also need to be measured at fair value as of the grant date. However, there is an additional requirement associated with liability awards, which is to remeasure the fair value at every reporting date.

- **Intrinsic value:** If the fair value of an equity-based award cannot be reliably measured, the intrinsic value method is applied.

  - **How does one establish that fair value cannot be reliably measured?**
    One of the rare cases where a company cannot establish reliable estimates of expected volatility either due to lack of historical data or unavailability of similar entities' volatility data, the intrinsic value method can be used.

  - **What is intrinsic value?**

    Intrinsic value of an ESOP = MAX (Exercise price – Fair value of share, 0)

    The difference between intrinsic value and fair value is that while the intrinsic value of an option may be zero (exercise price = fair value of share), the fair value will be higher than zero because it has another component i.e., time value. The option still stands a chance of converting to in-the-money (exercise price < fair value of share) before its expiry.